

The Taxing Wealth Report 2024

Every politician's guide to
"How to pay for it".

Income tax reform:

Capping the rate of tax relief on donations to charity to the
basic rate of income tax

Brief summary

This note suggests that:

- The higher rate of tax relief on donations made to charity by those who pay higher rates of income tax in the UK should be abolished.
- The existing relief is inequitable: it is inappropriate that those who pay higher rates of tax should be provided with a higher rate of tax relief when the action giving rise to that relief are the same whether a person is a basic or higher rate taxpayer.
- It is inappropriate that the higher rate of tax relief provided to the higher rate taxpayer as a result of their donation to charity benefits them and not the charity they donated to.
- This relief might distort the behaviour of charities within society.
- Removing this relief might save £740 million a year, increasing tax revenues by that amount as a result.
- Evidence collected by HMRC suggests that this relief has relatively little impact on the behaviour of higher rate taxpayers, who appear no more likely to use it than

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basic rate taxpayers, and that the behavioural consequence of the removal of this relief might be limited as a result.

<p>The proposal</p>	<p>To cut the rate of income tax relief on donations to charities by higher rate taxpayers so that they only enjoy relief at the basic rate of income tax, which is the rate of relief available to basic rate taxpayers.</p>
<p>Reason for the proposal</p>	<ol style="list-style-type: none"> 1. To improve the horizontal equity of taxation, which is currently undermined by higher rate tax relief that is available to those who gift to charity when only basic rate relief is available to a basic rate taxpayer. This issue is exacerbated by the fact that the taxpayer benefits from this higher rate relief: the charity does not. This adds to the inequitable impact of the relief. 2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity. 3. To reduce the tax spillover effect that existing rates of tax relief on donations to charity by higher rate income taxpayers create when compared to the relief available to those who are basic rate taxpayers. 4. To reduce the rate of tax abuse in the UK, some of which has been associated with the availability of this relief. 5. To consequently improve the rate of tax compliance in the UK. 6. To raise additional tax revenues.
<p>Estimated tax that might be raised as a result of the recommendation made</p>	<p>The behavioural response to this recommendation cannot be known with certainty.</p> <p>What is known is that HM Revenue & Customs believe² that higher rate tax relief on gifts to charities under Gift</p>

² <https://www.gov.uk/government/statistics/uk-charity-tax-relief-statistics>

	<p>Aid rules cost £740 million in the tax year 2022/23. The figure had increased from £480 million in 2014/25.</p> <p>Basic rate tax relief costs £1,600 million (£1.6 billion), which figure is assumed to include the basic rate relief on the sums also subject to higher rate tax relief.</p> <p>It is assumed that the sum of £740 million will be saved by abolishing this relief as a result.</p> <p>HMRC is concerned that this relief is being abused at present and has opened a review on that issue³.</p> <p>It has also been found that numerous errors in making Gift Aid claims are being made by taxpayers. This change in the relief would reduce the cost of these⁴.</p>
Ease of implementation	Simple.
Likely difficulties that might result from implementation	Few.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required	Short.

Background

In 2012 George Osborne suggested restricting the tax relief available to any taxpayer on the gifts that they might make to charity to the basic rate of income tax⁵. The result would have been that the higher rate tax relief on gifts to charity that those who pay tax at rates above the basic rate would have been eliminated. The reform was rejected after much protest, but it would appear timely to reconsider it.

A brief explanation of this relief is required. The government offers this explanation⁶:

³ <https://www.gov.uk/government/consultations/charities-tax-compliance/consultation-charities-tax-compliance>

⁴ <https://www.gov.uk/government/publications/charitable-giving-and-gift-aid-research>

⁵ <https://www.theguardian.com/uk/2012/mar/21/budget-2012-charities-tax-cap>

⁶ <https://www.gov.uk/donating-to-charity/gift-aid>

You can claim back the difference between the tax you've paid on a donation [you have made to charity] and what the charity got back when you fill in your Self Assessment tax return. It's the same if you live in Scotland. Do this either:

- *through your Self Assessment tax return*
- *by contacting HM Revenue and Customs (HMRC) and asking them to amend your tax code*

Example

Suppose a higher rate (40%) taxpayer donates £100 to charity. They claim Gift Aid tax relief. As a result, the charity can treat the gift as being worth £125, having grossed it up to allow for the 20% basic rate tax that has been deemed to have been paid on the income of the donor that has now been deemed to have been diverted to the charity for its benefit. The charity reclaims the £25 basic rate tax paid on the donation from HM Revenue & Customs.

The individual making the donation can now refer to that fact on their tax return and claim tax relief at 40% on the gross donation made i.e., on the sum of £125. The £25 that represented basic rate tax relief cannot be repaid to the taxpayer because the charity has already had the benefit of that sum. However, the higher rate tax paid, which amounts in this case to £25 (or £125 at 40% less the £25 paid to the charity) can be claimed as a reduction in the tax bill of the higher rate taxpayer in the year in which the donation is made. They get the benefit of this relief: the charity is not involved in this claim and does not benefit from it.

Discussion

There are three consequences of this relief.

Firstly, the overall tax rate of those with wealth is reduced by a greater sum if they give to charity than is the case if a basic rate taxpayer makes a gift of the same value. That is inequitable: there is no reason why tax rates should differ for this reason when the action undertaken is the same.

Second, this means that those with wealth can afford to give more to charity and so direct the use of the tax relief that a charity gets towards causes that matter to them more than most people can: this also appears inequitable.

Third, charities do not directly benefit from this tax relief, and that appears to make no sense when the relief is given to support charitable giving and not to reduce the tax rate of donors.

This tax relief at higher rates is poorly designed and increases inequality. It needs to be abolished for that reason.

That reform would not harm charities: they get the same relief either way, and it makes sense that taxpayers should be treated in the same way as well in that case. Equity does suggest as a result that reform is now timely and appropriate.

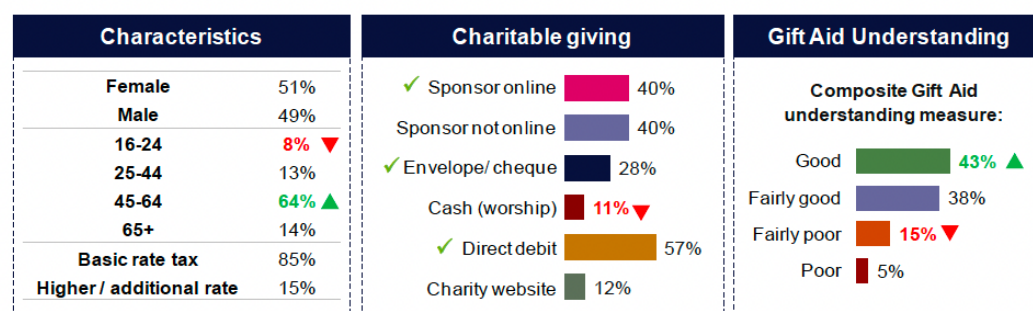
Behavioural responses

There is no clear evidence that there would be a behavioural response to the abolition of this relief. In 2018 HM Revenue & Customs published a paper⁷ on the use of Gift Aid reliefs. Interestingly they noted this data with regard to those taxpayers who were the most likely to claim Gift Aid relief:

A. Eligible and always add Gift Aid

Donors in this group are important to charities as their support for charitable causes generates a sizeable proportion of charities' income. They will consistently generate additional income for charities by adding Gift Aid to their donations, primarily via direct debit donations.

Figure 23: Key characteristics, levels of charitable giving and Gift Aid understanding among eligible donors who always add Gift Aid.



▲▼ Significantly higher / lower than average
 ✓ Channels that contribute most to the Gift Aid value added by the group

Base: Eligible donors who always add Gift Aid (190).

This group accounts for 12% of donors. They are likely to be aged between 45 and 64 years, suggesting financial stability from a steady income stream. Most (85%) are basic rate taxpayers, while 15% are higher or additional rate taxpayers.

⁷ <https://www.gov.uk/government/publications/charitable-giving-and-gift-aid-research>

Surprisingly, only twelve per cent of donors always add Gift Aid to their gifts to charity. More surprisingly still, of these only 15% are higher rate taxpayers, which is a figure only slightly more than their representation in the population of taxpayers as a whole. It does not as a result seem that this relief is of any great consequence to higher rate taxpayers or to their inclination to donate to charity.

As a result, it seems unlikely that there will be any significant behavioural response to this proposal, despite the protestations of those who might suggest otherwise, including charities.